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No. 90-1503

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

JOHN G. ORDWAY, JR. and MARGARET M. ORDWAY,
Petitioners,

v.

UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit

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REPLY BRIEF FOR PETITIONERS

BURTON G. ROSS
Counsel of Record
CYNTHIA S. ROSENBLATT
ROSS, ROSENBLATT & WILSON, LTD.
4000 Piper Jaffray Tower
222 South Ninth Street
Minneapolis, MN 55402
(612) 339-4141

CLARK M. CLIFFORD
ROBERT P. REZNICK
CLIFFORD & WARNKE
815 Connecticut Avenue
Washington, D.C. 20006
(202) 828-4200
Counsel for Petitioners

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REPLY BRIEF FOR PETITIONERS

Respondent's Opposition misstates Petitioners' legal argument to this Court and largely ignores the issues raised in this case. It succeeds, however, in demonstrating that the scope of the constitutional prohibition against retroactive excise taxation is squarely presented on the facts, and that this case is a thoroughly appropriate vehicle by which to correct the court of appeals' significant break with an important and longstanding line of constitutional authority.

I. PETITIONERS WERE DENIED THEIR CONSTITUTIONAL RIGHT TO BE FREE FROM RETROACTIVE GIFT TAXATION

In order to appraise the worthiness of Petitioners' constitutional claims, it is necessary to sweep away the misconceptions and evasions that fill Respondent's brief, and

recognize the sharply defined legal issues that are acknowledged to be raised in this Petition. Respondent incorrectly states, for example, that this case is controlled by the Court's decision in *Jewett* v. *Commissioner*, 455 U.S. 305 (1982), wrongfully suggesting that Petitioners seek a reversal of that case in order to address their claims. The question, rather, is whether the court of appeals' extension of *Jewett* to the disclaimer of an interest created prior to enactment of the gift tax crossed a boundary of constitutionally prohibited action that has been firmly in place for more than sixty years and endorsed by all three branches of government. Respondent's error is in ignoring completely this history, and with it the constitutional issue presented.

Respondent contends that whether an excise tax is retroactive in the context of a disclaimer is determined *solely* with reference to the date when the disclaimer is made. Opp. 6. This argument is based exclusively upon Respondent's citation to the broad *statutory* and *regulatory* definitions of "gift" as including the act of disclaimer. Opp. 6-7. But Petitioners do not dispute that a disclaimer can be a "gift;" *Jewett* so held. What Respondent has ignored is that there exists a *constitutional* limitation on the temporal operation of gift tax statutes—that in assessing the question of retroactivity there is, in other words, a need to focus not on the date of the disclaimer but on the date when the interest passing as a consequence of the disclaimer was created. Pet. 14. Respondent's extreme position, mirroring that of the court of appeals, properly frames this constitutional issue for resolution by the Court.

Congress (since its first effort to tax gifts was declared unconstitutionally retroactive by this Court) uniformly has recognized that retroactivity in the context of disclaimers must refer to the date when the interest disclaimed was created, not, as Respondent urges, when the disclaimer is made. Pet. 11-12. It has been recognized as

well by this Court in *Jewett* and indeed even by the Government in its arguments to the Court in that case. *Id.* 12-13. This compelling weight of constitutional authority is left unanswered by Respondent.

Respondent is completely silent on the settled constitutional jurisprudence as understood by Congress—the body responsible in the first instance for implementing the prohibition against retroactive gift taxation. As for *Jewett*, Respondent dismisses as "merely descriptive" the Court's explanation (455 U.S. at 317) that the taxpayer had no " 'right' " to disclaim free from tax because the interest disclaimed was created after enactment of the gift tax. Opp. 7-8 n.4. The Court's opinion, however, quite obviously cites the post-gift tax creation of the interest as a principal reason why no "right" to disclaim free of tax existed. Of equal significance is the Government's own brief in *Jewett* (quoted at Pet. 13), which advanced this position and which the Court adopted. The Government's linkage of a pre-gift tax transfer and a "right" to disclaim free from tax is a model of clarity and persuasiveness, and flatly contrary to Respondent's position in this case. Respondent, however, has chosen to ignore this language as well.

Retroactive excise taxation is prohibited by the Due Process Clause to preserve the legitimate and settled expectations of donors who part with property voluntarily and irrevocably. *See Welch* v. *Henry*, 305 U.S. 134, 147 (1938). Here, for example, a trust was established in 1917, fifteen years prior to enactment of the gift tax. The transfer into trust was not then taxable, nor was the creation of any of the vested and contingent rights that sprang therefrom. Included among those rights was that of a beneficiary to disclaim causing property to be transferred under the trust to an alternate beneficiary designated by the donor. It is of no moment that Petitioner did not disclaim until his interest vested in 1979, a fact

Respondent repeats time and time again. The "delay" in disclaiming is really no delay at all, but merely the exercise of a right guaranteed by the Constitution. When the donor relinquished control of his property in 1917, the exercise of that right to disclaim in conformity with state law was understood to be free from taxation.[1] So must it remain.[2]

II. A CONSTITUTIONALLY TAX FREE 1917 TRANSFER INTO TRUST CANNOT BE A "TAXABLE TRANSFER"

Wholly apart from the constitutional problems of applying the treasury regulations to the disclaimer in this case, Petitioners argue that the court of appeals improperly determined that the 1917 transfer satisfies the jurisdictional requirement of a "taxable transfer" contained in the amended treasury regulations. Pet. 16-19. Respondent acknowledges (Opp. 6) that the 1917 transfer "cannot constitutionally be subject to [the gift] tax," but maintains (*id.* 9) that it nevertheless can be a "com-

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[1] Respondent attributes to Petitioners the claim that the disclaimer of a pre-gift tax interest may never be subject to federal tax. Opp. 6. This is categorically false. At the time the trust was created (and as remains the case), state law established requirements that must be satisfied for a disclaimer to be effective, including requirements as to when the disclaimer must be made. Pet. 3. If those requirements are not met the disclaimer is not valid, and a gift tax properly may attach. Petitioners' contention, rather, is that neither Congress nor Respondent by regulation may constitutionally superimpose on trust beneficiaries a separate federal disclaimer standard that was not reasonably foreseeable by the donor at the time of the irrevocable transfer. Pet. 6 n.7.

[2] The fairness of this rule is demonstrated by observing that Lucius Ordway in 1917 could have achieved the purposes of his trust in either of two ways: As he did, by the creation of contingent interests subject to disclaimer, or by conferring upon descendants like Petitioner a general power to appoint themselves the beneficiary of the trust corpus, subject to the release of that power. Had Lucius Ordway chosen the latter course, there would be no question but that Petitioner's release of the general power of appointment in 1979 would have been free of tax. *See* Pet. 12 n.12.

pleted gift for purposes of the gift tax," thus satisfying the regulatory requirement. Respondent then attempts to shield its improbable construction from review with a vague claim that it is entitled to "considerable deference" in interpreting the treasury regulation. *Ibid.*

There is no dispute that agencies are entitled to deference in construing ambiguous regulations which they administer. The rule is well settled, however, that an agency may not interpret its own regulations to conflict with the regulations' "plain language." *Gardebring* v. *Jenkins*, 485 U.S. 415, 430 (1988); *Bowles* v. *Seminole Rock and Sand Co.*, 325 U.S. 410, 414 (1945). Such is the case here.

On its face, a "taxable transfer" cannot embrace a constitutionally tax free transfer except through an act of acrobatic circularity, one which begs the question whether a transfer is a "completed gift for Federal gift tax purposes." *See* Treas. Reg. § 25.2518-2(c)(3). Moreover, Treasury Regulations §§ 25.2511-2(a) and (b) make unequivocally clear that gifts completed for gift tax purposes can include only those transfers which are subject to the gift tax.[3] Since, as both parties agree, the 1917 transfer is not subject to the gift tax, it cannot be a "completed gift for Federal gift tax purposes." And the fact that the amended regulation's "taxable transfer" requirement may be met "regardless of whether a gift tax is imposed on the completed gift" (Opp. 9) can-

[3] Treasury Regulations §§ 25.2511-2(a) and (b), which define when a gift has been completed, provide in pertinent part that: "The gift tax is not imposed upon the receipt of the property by the donee . . . . On the contrary, the tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable. . . . As to any property, or part thereof or interest therein, of which the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another, the gift is complete."

not expand the scope of that regulation to reach a transfer which—in conformity with constitutional limitations—the regulation was never intended to embrace. Respondent's construction reads the word "taxable" out of the phrase "taxable transfer," an error compounded by the fact that the regulation was amended in 1986 specifically to add that word. *See* Pet. 7 n.8.

Petitioners demonstrated that the court of appeals' construction of the treasury regulations governing disclaimers would promote taxpayer abuse. Pet. 19-21. Respondent disagrees, citing examples in the regulations that correctly state what the regulations provide, but that happen to be wholly at odds with what the court of appeals said. Opp. 9-10 n.5. Specifically, the court concluded "that for purposes of measuring time . . . a taxable transfer occurs *whenever there happens* 'any transaction in which an interest in property is gratuitously passed or conferred upon another.'" Pet. App. 9a (citation omitted) (emphasis added). It is this overly broad interpretation, which effectively removes the limitations of Treasury Regulation § 25.2518-2(c)(3), that causes the decision of the court of appeals to be a significant and potentially very disruptive departure from settled law. Respondent has said nothing to lessen that concern, or to justify construing an unambiguous regulation contrary to its plain meaning to achieve an unconstitutional result.

III. THE COURT OF APPEALS' IMPROPER RETROACTIVE APPLICATION OF *JEWETT* v. *COMMISSIONER* IS PROPERLY BEFORE THE COURT

Respondent answers Petitioners' claims that the court of appeals improperly gave *Jewett* retroactive application by throwing up a series of imaginary procedural roadblocks to review by this Court. It is simply not true that Petitioners "acknowledge" that they did not urge in the court below the nonretroactivity of *Jewett*. Opp. 10. On the contrary, Petitioners' justifiable reliance upon

the decision in *Keinath* v. *Commissioner*, 480 F.2d 57 (8th Cir. 1973), and the unconstitutionality of applying *Jewett* to them, has been a primary contention throughout. *See* Pet. 21-22. And it clearly is not the case that this Court is foreclosed from considering the manifest injustice visited by retroactive application of the 1982 *Jewett* decision to a 1979 disclaimer—an issue addressed fully by the dissent in the court of appeals.[4] Pet. 22-23; *id.* App. 13a-14a.

Respondent's denial that Petitioner exercised reasonable reliance on the *Keinath* rule in declining to disclaim prior to 1979 similarly misstates the governing law. Respondent asks: How could Petitioner have relied on *Keinath*, which was decided 32 years after he learned of his interest, and 11 years after promulgation of the first disclaimer regulation (Opp. 11)? The answer is that *Keinath* by its own terms merely restated what was universally considered theretofore to have been the governing law.[5] Pet. 24-25; *Keinath*, 480 F.2d at 64. An equally persuasive answer is that the Commissioner of Internal Revenue expressly advised residents of the

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[4] *EEOC* v. *FLRA*, 476 U.S. 19 (1986), the sole authority cited by Respondent in support of its claim of a procedural bar, involved a *statutory* prohibition against judicial review of certain claims and is patently inapposite.

[5] The only case involving the disclaimer regulation prior to *Keinath* was *Fuller* v. *Commissioner*, 37 T.C. 147 (1961), which held that there can be no effective disclaimer of an immediate noncontingent life estate after its acceptance. *See* Pet. App. 21a-22a. No acceptance of any interest at issue here was made by Petitioner. And *Fuller* cannot be considered notice (Opp. 11) that disclaimers of contingent remainder interests were to be effected in any manner other than in accordance with the prevailing common law. Respondent also contends (Opp. 12) that the issue of reasonable reliance upon *Keinath* was rejected by this Court in *Jewett*. The taxpayer in *Jewett*, however, was not an Eighth Circuit resident and made his disclaimer more than six months before *Keinath* was even decided. The reliance issue presented here thus was never before the Court in *Jewett*.

Eighth Circuit (such as Petitioners then were) that he would follow *Keinath* for subsequently-made disclaimers, no matter how long the interest disclaimed had been held. Pet. 24.[6] Respondent's reversal of Petitioners' fortune thus indeed is at the expense of legitimate, legally protectable reliance interests.

CONCLUSION

This case places at risk the disposition of what Respondent does not dispute may be tens of billions of dollars of trust assets, if not more. It involves continuing and significant constitutional issues potentially affecting every taxpayer and the permissible scope of all subsequent legislation involving gift taxation. The Petition for Certiorari should be granted.

Respectfully submitted,

BURTON G. ROSS
Counsel of Record
CYNTHIA S. ROSENBLATT
ROSS, ROSENBLATT & WILSON, LTD.
4000 Piper Jaffray Tower
222 South Ninth Street
Minneapolis, MN 55402
(612) 339-4141

CLARK M. CLIFFORD
ROBERT P. REZNICK
CLIFFORD & WARNKE
815 Connecticut Avenue
Washington, D.C. 20006
(202) 828-4200
Counsel for Petitioners

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[6] As late as 1980 the Government continued not to challenge application of the *Keinath* rule to taxpayers situated as Petitioners. *See Cottrell* v. *Commissioner*, 628 F.2d 1127, 1131 (8th Cir. 1980) (en banc).